



# Bauerle's Bank Notes

December 17, 2013

## Value Play

Two weeks ago in this space, we observed that a South American bank ceo writing recently in the Financial Times echoed our call 13 years ago that eBay's PayPal service is a bank-in-drag. This weekend, Barron's joined the chorus. Ironically, Barron's profiled eBay as a value stock play, at least among tech stocks, due to the underappreciated, large and steady cash flow thrown off by its banking franchise.

Titled "How PayPal Could Drive eBay Higher," the Barron's piece said,

[PayPal] has become a key growth contributor. Its profits should expand at a compounded rate of 17% per year through 2015, versus 10% for marketplace profits [derived from e-commerce sales of goods] . . . . That would raise PayPal's profit contribution to 35% by 2015 from 31% in 2012. Much of PayPal's past growth has come from its increased use online, at eBay.com and other e-commerce sites. Now, the company is taking on offline-payment networks, like Visa (V) and MasterCard (MA), by striking deals with retailers that allow shoppers to pay with PayPal accounts using their mobile phones. . . . Shoppers aren't exactly running low on payment options, of course, but rewards programs can win fans quickly, and here PayPal has a key structural advantage. An estimated 40% of its transactions use the Automated Clearing House, a bank transfer service overseen by the Federal Reserve. This free ride of sorts give PayPal outsize cash flow that it's spending now to expand, but can later put toward shopper perks. (emphasis added)

So there you have it, again. A free ride, outsize cash flow, and the ability to woo customers with loyalty programs paid for by the competition, namely banks and the Federal Reserve System they support. What's more, to keep its story simple, Barron's omitted any reference to eBay's recently-introduced BillMeLater service, which is potentially a much bigger threat to banks as it diverts consumer installment spending and debt to eBay's affiliated bank. Said bank makes Wal-Mart's failed 2006 bid to charter an industrial loan

company look like child's play.

Bankers participating recently in our Black & Gold Financial Team gatherings expressed alarm at this patently unfair situation. As a result, we are preparing a campaign to mobilize regional banks and their executives and directors to highlight the problem before Congress and seek legislative redress. Details of the effort we will share with you in January.

In the meantime, bankers have opportunities closer to home to build customer loyalty and harvest embedded business value. Our Black & Gold events allowed us to listen to and learn from nearly 50 bank executives. As a result, we are also at work preparing other offerings that will unlock underappreciated value in clients' existing banking franchises.

Sunday's Pittsburgh Tribune-Review contained two articles about bitcoin and other so-called crypto-currencies. The news brought to mind our nation's switch 150 years ago from commerce paid for in bimetallic specie to paper currency. Eastern bankers fought for decades to preserve a gold-based currency, including by spending \$3 billion, in today's dollars, to elect President William McKinley in 1896. That represents \$422 for every vote cast for McKinley, a record that stands to this day despite the oft-stated but erroneous claim that the 2012 Presidential election was the most expensive. Yet multiple wars, depressions and other economic dislocations made the transition to fiat currency inevitable.

Nowadays, astute bankers do not seek to roll back the tide of digital commerce. They are about the business of adapting to the emerging digital economy, reconstructing their franchises and redefining their value in the marketplace. To be sure, plenty of challenges and opportunities lie ahead. To meet them, we look forward to continuing to be a resource for you, our clients and other interested readers, in the new year, and thank you for your patronage in this one.